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In the Supreme Court
OF THE
United States

OCTOBER TERM, 1962

No. 21

UNITED STATES,
Petitioner,
vs.
DON GILMORE and SUE GILMORE,
Respondents.

On Writ of Certiorari to the United States Court of Claims.

SUPPLEMENTAL BRIEF FOR RESPONDENT DON GILMORE

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INTRODUCTORY STATEMENT

The brief of petitioner, although essentially similar to the brief which it replaces, adds some additional thoughts and materials which call for a response by respondent. This brief will not replace but will be supplemental to respondent's brief heretofore filed.[1]

[1] Respondent's brief filed in the 1961 term (No. 257) will be referred to herein as Resp. Br.

STATEMENT

Petitioner has made the following important concessions of fact.

1. "We do not challenge the Court of Claims allocation of the expenses. * * *" Pet. Br. p. 8.

2. "We concede that the sole reason why the respondent incurred the expenses for which a deduction was allowed was to prevent the loss of his stock and possibly his job." Pet. Br. pp. 8, 9.

3. "We * * * stipulate that the sole reason why respondent spent the $32,500 was to keep his stock, his corporations' franchises, and his jobs." Pet. Br. p. 16.

4. "* * * We acknowledge that there was a direct and immediate relationship between the expenses and the retention of income-producing property (the stock) and of an income-producing capacity (the job), for that was indeed the sole reason why the expenses were incurred." Pet. Br. p. 16.

ARGUMENT

I. The first concession of petitioner that "we do not challenge the Court of Claims allocation of the expenses" relates to the finding of fact number 30. (R. 137). This finding states that the evidence establishes that 80 per cent *or more* of the expenses were for services to defeat the wife's claims to one-half of the value of the increase of his stock and to estab-

lish that no portion of the stock was community property. To defeat the claims, to one-half of the value of the increase and to establish that no portion of the stock was community property, in legal effect means the same thing because the wife automatically becomes entitled to one-half of any community property. It should be observed that all that the wife claimed was one-half, not more than one-half.

Petitioner, however, in the face of said concession and said allocation in finding 30 asserts that the allocation be split into segments, viz.: (1) establishing that no part of the stock was community property, (2) establishing his right, and defeating his wife's, to more than half of whatever community property there was; and (3) protecting his reputation with General Motors against charges of personal misconduct. Pet. Br. pp. 7, 8. Again at page 51 of petitioner's brief it is asserted that "it is necessary to distinguish between (a) the expenses incurred to defend the charges of respondent's misconduct made by his wife and to support the charges of her misconduct made by him and (b) those incurred to establish that no community property existed." Again under the heading on page 54 of petitioner's brief, "The Costs of Litigating the Existence of Community Property," petitioner suggests that this court should remand the case to the court below to consider the amount to be allocated to the costs of resisting the wife's claim that part of the stock was community property and also for the proper characterization of such costs. Pet. Br. pp. 55, 57, 66.

But the Court of Claims has already considered and decided upon the various services rendered by respondent's attorneys and the proper allocation of their charges. The court below found from the evidence that the major part (80% or more) of the compensation paid to the attorneys was for their accomplishment in defeating the wife's claim to one-half of the increase in the value of the stock. (R. 137.) Petitioner has not directly attacked this finding of fact. Moreover, this finding is conclusive on the Supreme Court. *U.S. v. Esmond-Pettis*, 308 U.S. 26, 29, 58 S. Ct. 112, 114; *Niles Bement Pond Co. v. U.S.*, 281 U.S. 357, 360, 50 S. Ct. 251, 252.

Petitioner suggests that the services of the attorneys with respect to misconduct would not have had to be so intense and so extensive if it were not for the possibility that the wife might get the divorce and more than half of whatever amount of community property might be determined. However this was for the Court of Claims as a trier of fact to consider, and a review of the findings shows that it did. What weight was given to it does not necessarily have to appear in the findings.

Thus the concession aforesaid made by petitioner and the findings of fact of the Court of Claims preclude the position taken by petitioner that the 80% of the expenses be split up and further allocated.

II. The other concessions (numbers 2, 3 and 4) of petitioner concede that the expenses in question were incurred solely to protect, save from loss and in that

sense to conserve or preserve respondent's stock. But, says petitioner, the expenses are non-deductible because the origin and nature of the expenses characterizes them primarily as "personal" expenses and perhaps in part capital expenditures. Pet. Br. 16.

The origin and nature of the expenses (as distinguished from cause and purpose), contends the petitioner, have been tainted by the divorce action and thus casts them as personal expenses under Internal Revenue Code Sec. 24(a)(1) and Regulations 118, Sec. 39.24(a)-1 and 1954 Code Sec. 262 and Regulations 1 (1954 Code) Sec. 1.262-1(b)(7). It has been previously shown (Resp. Br. pp. 15, 16) that the Regulations 118 Sec. 39.24(a)-1 and Regs. 1 (1954 Code) Sec. 1.262-1(b)(7) recognize that attorney's fees are deductible even though incurred and have their origin in a divorce case if properly attributable to the production or collection of alimony income. The regulations do not provide that the deductibility of attorney's fees in connection with the production or collection of alimony is the only case in which the deduction of attorney's fees is to be allowed in regard to matters arising in a divorce case. This so-called exception comes under Sec. 23(a)(2) and Sec. 212(1) and (2) which treat expenses paid or incurred for the management, conservation or maintenance of property held for the production of income as co-extensive with expenses paid or incurred for the production or collection of income. Therefore if attorney's fees are for services to

conserve property held for the production of income, the result should be the same.

As is pointed out by petitioner's brief (footnote p. 45), the regulations were amended to recognize the deductibility of attorney's fees incurred in the production or collection of alimony income, to conform to the decisions in *Le Mond v. Commissioner*, 13 T.C. 670, and *Gale v. Commissioner*, 13 T.C. 661. In the latter case the Commissioner argued that "such expenses arose out of the marital relationship existing between the petitioner and her husband and, therefore, constituted purely personal and family expenses, the deduction of which is expressly prohibited by section 24(a)(1) of the code." 13 T.C. p. 667. The Tax Court rejected this argument. The test laid down by the Tax Court is as follows:

> "To be deductible under section 23(a)(2), expenses must be ordinary and necessary, reasonable in amount, and *must bear a reasonable and proximate relation* to the production or collection of income, or for the management, conservation or maintenance of property held for the production of income." (Emphasis added) 13 T.C. p. 667.[2]

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[2] To underline the conflict between *Bass v. Commissioner*, 196 F. 2d 643 (C.A. 8), and the cases following it (Resp. Br. pp. 16-17), and *Lewis v. Commissioner*, 253 F. 2d 821, petitioner states in a footnote: "The Tax Court, too, has remained firm." (Pet. Br. 47). As support petitioner cites the leading authority of the Tax Court *Douglas v. Commissioner*, 33 T.C. 349. It is submitted, however, that *Douglas v. Commissioner* does not repudiate *Bass v. Commissioner*, *supra*, any more than did the Court of Claims in the recent case of *Davis v. U. S.*, 287 F. 2d 165, which was reversed on other issues, 370 U.S. 65, and on the facts of which the court held not deductible the costs of resisting the wife's demands in a

Petitioner's footnote (Pet. Br. 40, 41) discussing *Joyce v. Commissioner*, 3 B.T.A. 393, is reminiscent of the argument in the brief of the Commissioner in *Gale v. Commissioner*, *supra*, relying on *Joyce v. Commissioner* and other early cases. With reference to the Commissioner's argument that the lawyer's fees were personal and family expenses within the meaning of section 24(a)(1), the court in *Gale v. Commissioner* said, "The cases relied on by the Commissioner on brief . . . are distinguishable either on the facts presented or by the circumstance that neither section 23(a)(2) nor section 22(k) was part of the revenue laws when the cases were decided." 43 T.C. 661, 663.

In a footnote (Pet. Br. 39), petitioner refers to 1954 Code Sec. 212(3) which permits the deduction

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divorce action to stock which was not necessary to the husband for a livelihood as an officer and director of the corporation.

The Tax Court saw a distinction in the facts of *Douglas* from the facts in *Bates v. Commissioner*, *supra*, *Bates v. Commissioner*, 241 F. 2d 904 (C.A. 6), and *H. Wachtel v. U.S.*, 167 Ct. Cl. 132, F. S. 114, but did not disapprove or state that it refused to follow the rule of those cases. The court in *Douglas* stated in reference to those cases:

> "It is readily seen that these cases allowing deduction of expense under section 23(a)(2), as being conservatory of income producing property all concerned property having peculiar and special value to the husband aside from its normal or intrinsic value. The opinions overlap resulting in the effect that the controversy between husband and wife did not go to the question of liability for alimony or even its amount, but solely or primarily to the manner in which it might be paid.
>
> "There is not one in the instant case to bring it within the rationale of the above cases. The community property had not peculiar or special value to petitioner aside from its normal or market value." 23 T.C., p. 356.

of expenses incurred "in connection with the determination, collection or refund of any tax." Although this provision is just as much subject to the personal restrictions of Sec. 262 as subdivisions (1) and (2) of Sec. 212, petitioner admits that legal expenses incurred in connection with the determination of any tax even personal in origin (i.e. personal property tax, personal income tax, gift tax, etc.) are deductible.

III. Petitioner mistakenly compares the claim of the wife to one-half of the increase in value of respondent's stock with the claim of the government to a gift tax in *Lykes* v. *United States*, 343 U.S. 118, on the ground that the origin of attorney's fees incurred in both cases was for services in defense of personal liabilities. (Pet. Br. 36, 38, 39, 40.)

Since this case was first argued this court decided *United States* v. *Davis* (6/4/62), 370 U.S. 65, 82 S. Ct. 1190. The court's decision leaves no doubt that when community property rights are involved they cannot be ignored as petitioner would do in Points I and II of its brief. (Pet. Br. 17) *United States* v. *Davis* makes it clear that unlike claims of wives in common law states, a wife's demand in respect to community property is not a claim of personal liability of the husband. (Petitioner seems to admit this is so. Pet. Br. 63.) When a wife makes a claim to community property against her husband in a proceeding for the dissolution of community property which may, but not necessarily, occur in the divorce case, the claim is one of a right to a division of alleged community property. A quotation from the

opinion in *United States* v. *Davis* 82 S. Ct. p. 1193, will make this clear.

> "Regardless of the tags, Delaware seems only to place a burden on the husband's property rather than to make the wife a part owner thereof. In the present context the rights of succession and reasonable share do not differ significantly from the husband's obligations of support and alimony. They all partake more of a personal liability to the husband than a property interest of the wife. The effectuation of these marital rights may ultimately result in the ownership of some of the husband's property as it did here, but certainly this happenstance does not equate the transaction with a *division* of property by co-owners. (Emphasis added.) Although admittedly such a view may permit different tax treatment among the several States, this Court in the past has not ignored the differing effects on the federal taxing scheme of substantive differences between community property and common-law systems. *E.g.*, *Poe* v. *Seaborn*, 282 U.S. 101 (1930). To be sure Congress has seen fit to alleviate this disparity in many areas, e.g., Revenue Act of 1948, 62 Stat. 119, but in other areas the facts of life are still with us."

IV. The parallel between the situation in *Kornhauser* v. *United States*, 276 U.S. 145, and the situation involving attorney fees in an action between husband and wife for an accounting and dissolution of community property, is most striking.

In *Kornhauser* there had been a suit for an accounting between two former law partners, in which it was

claimed by one against the other that stock in a corporation which was acquired after the dissolution of the partnership by one of the partners was received for services performed during the existence of the partnership and should be divided between the partners. The defense of the suit was successful and the attorney's fee paid by the successful partner was taken as a deduction from his gross income as a business expense. The deduction was disallowed on the ground that it was a personal expense, the extra tax was paid and a suit for refund of the tax paid was subsequently filed in the Court of Claims. A demurrer to the petition for refund of the tax was sustained on the ground that the attorney's fee was not a deductible business expense but was a personal expense. Apparently the government also contended that the expense was incurred to protect property and was non-deductible as a capital expense. (See *Rassenfoss v. Commissioner*, 158 F. 2d 764, 766). The Court of Claims was reversed on the holding that the expense was a business expense having proximately resulted from the business of the taxpayer.

In the case at bar, Don Gilmore, the respondent, and his wife were, under California law, marital partners, both being equally entitled to community earnings and profits. (Resp. Br. 12, 13, 14, 15) In the action by the wife against respondent, the wife alleged that she was entitled to one-half of the increase in value of his stock, the gain being attributable to the earnings of the community. Respondent contended that the gain was attributable to his separate property and that it should not be divided with his wife.

There was an accounting of the community earnings and expenditures in the action and the court on the facts and the law held that the increase in value of the stock was not community property and did not have to be divided with the wife. The respondent incurred attorney's fees in the proceeding which he deducted from his gross income on the ground that they were incurred under section 23(a)(2) to conserve property held for the production of income. The Commissioner of Internal Revenue disallowed the deduction of the expenses on the ground that they were personal under section 24(a)(1). The Court of Claims reversed on the ground that the attorney's fees were proximately related to the conservation of property held for the production of income.

If we assume for a moment that the two law partners in *Kornhauser* were husband and wife, should the result have been any different if the accounting action in regard to the stock had occurred in divorce proceedings between them? Would the fact that the dissolution of the partnership occurred because of marital differences between the husband and wife defeat the right to the deduction of the attorney's fees as personal expenses in the accounting action? It is submitted that the result in *Kornhauser* would not have been different since the rule laid down in that case required only that the expense proximately relate to the business of the partnership.

In the case at bar, respondent and his wife were not in business but they were quasi-business partners and the increase in value of stock of the respondent

was subject to an accounting and the possibility that it was in whole or in part community property consisting of community earnings. The stock was property held for the production of income within section 23(a)(2). The claim of a wife to half of the increase in the value of the stock failed.

The analogy of *Kornhauser* to *Gilmore* is clear. It was the purpose of Sec. 23(a)(2) to afford equality of treatment with Sec. 23(a)(1) of non-business expenses when proximately related to the "conservation" of property held for the production of income. In *Sorgievsky* v. *McVitty*, 135 F. S. 233, 237, footnote 7, the following comment illuminates the point:

> "The *pari materia* rule of the Bingham decision has suggested the rather frequent analysis of first ascertaining whether an expense would be deductible had it resulted from a business transaction. If so, it is then held that the expense is deductible as a nonbusiness expenditure, inasmuch as all other requirements are substantially identical in construing §§ 23(a)(1) and 23(a)(2). The Supreme Court itself used this analysis in the Bingham case."

It is also important to observe that in *Kornhauser* as in the case at bar (Pet. Br. p. 54 et seq.), it was contended by the government (276 U.S., footnote p. 147, 48 S. Ct. 219, 220), that the expenses were incurred in defense of an accounting suit for the purpose of protecting property and that they were capital expenses. As previously stated, the Court of Claims, which sustained the government's theory was reversed. (See *Rossiafoss* v. *Commissioner*, *supra*.)

V. Petitioner's contentions (Pet. Br. pp. 51, 52, 53) notwithstanding, the Court of Claims in its findings of fact concluded that the misconduct charges had a direct bearing on the issue of whether the increase in value of the stock was community property. Finding 23 (R. 132):

> "(b) The credibility of the parties became an important factor in the evaluation by the trial court of the entire case, including both the misconduct and community property issues. Don Gilmore's attorneys feared that if the trial judge believed Dixie's charges, he might also find that there was community property and award all or most of it to her.
>
> "(c) There was an issue as to whether oral declarations and conduct between the parties had affected the nature of the property in dispute."

Finding 29 (R. 136):

> "None of the three attorneys who represented Don Gilmore kept records in which he undertook to allocate what percentage of his time or efforts was devoted to each of the several issues involved in the divorce litigation. However, each of them testified that more than 80 percent of the legal services which they rendered and for which they were paid by Don Gilmore in 1953 and 1954 were directed toward preserving his stock in the three dealerships as his separate property and in defeating Dixie Gilmore's claim that she was entitled to one-half of the increment in the value of that stock that occurred during the marriage."

In consideration petitioner's theory, viz: that the legal expense of respondent in respect to the deter-mi-

nation that none of the increment in value of the stock was community property be reallocated and treated as a non-deductible capital expense, it must be remembered that aside from the fact that the court below already made a final allocation (R. 137, F. 30), the controversy between respondent and his wife over what was and what was not community property partook of an accounting suit between marital partners. (See R. 133, F. 21; R. 135, F. 28(b); R. 131, F. 20(c).) The case authorities in this area reject the theory that legal expenses in defense of claims by partners in an accounting must be capitalized. The conflict is not over title to property; it is more in the nature of rights to and results of participation in earnings and the division, if any, to be made between the parties. See *Kornhauser* v. *U.S.*, *supra*, *Rassenfoss* v. *Commissioner*, *supra*, and *Sergievsky* v. *McNamara*, *supra*.

CONCLUSION

For the reasons given in respondent's briefs, the judgment of the Court of Claims should be affirmed.

Dated, San Francisco, California,
November 14, 1962.

Respectfully submitted,

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